

IT 95-58
Tax Type: INCOME TAX
Issue: Non-Filer (Income Tax)

DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS

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DEPARTMENT OF REVENUE      )  
STATE OF ILLINOIS         )  
                           )   Docket:  
      v.                   )  
                           )  
XXXXXX                    )  
                           )   Wendy S. Paul  
                           )   Admin. Law Judge  
      Taxpayer(s)         )  
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX, attorney for XXXXX

SYNOPSIS: This matter comes on for hearing pursuant to the taxpayer's timely protest to a Notice of Deficiency issued by the Department on January 23, 1995 for tax deficiencies and penalties arising out of taxpayer's failure to file Illinois income tax returns and pay taxes for tax years ended 12/31/85 through 12/31/90. After the issuance of the Notice of Deficiency, taxpayer paid the deficiencies asserted in the Notice. In its protest, taxpayer contested only the imposition of penalties. At issue is the question of whether reasonable cause existed for the abatement of penalties pursuant to 35 ILCS 5/1001 and 35 ILCS 5/1005.

FINDINGS OF FACT:

1. During the audit years, taxpayer was a Subchapter S Corporation which failed to file Illinois income tax returns (Forms IL-1120-ST) as required by 35 ILCS 5/502(a)(2). (Dept. Ex. No. 3, 4)

2. The two shareholders of taxpayer were former teachers who provided remodeling services, initially working out of their homes on a part-time basis, and eventually opening an office and working full time.

(Testimony of XXXXX, Vice-President, Taxpayer)

3. Prior to the audit years, the business was operated as a partnership and an accountant had prepared their tax returns. (Taxpayer Group Ex. No. 1)

4. In 1984, coinciding with the time that the business began to be operated on a full time basis, the owners retained a different accountant to handle all of their bookkeeping, accounting, payroll and tax preparation. (Testimony of XXXXX)

5. The accountant advised them to change their status from a partnership to a Subchapter S corporation. The accountant advised that the corporation itself would owe no taxes, as all profit or loss would be reported on the owners' personal tax returns. (Testimony of XXXXX)

6. This accountant had been recommended to the owners by various people, including the sister of one of the owners who operated an antiques business, and the owners knew that the accountant had done bookkeeping, payroll and tax preparation for other construction companies. (Testimony of XXXXX)

7. During the audit period, the accountant came to the taxpayer's office once or twice a week. All notices or papers relating to taxes were put in a bin specifically reserved for the accountant. (Testimony of XXXXX)

8. The owners were not knowledgeable about tax or accounting, and relied entirely upon the accountant for all accounting, payroll, bookkeeping and tax preparation. They relied upon and followed all of the accountant's instructions. (Testimony of XXXXX)

9. During this period, the accountant never advised taxpayers to file a Form IL-1120-ST. (Testimony of XXXXX)

10. During the audit period, federal returns were filed; there were no audits or notices of tax due; and the owners assumed that the accountant

was competent. (Taxpayer Group Ex. No. 1; Testimony of XXXXX)

11. Immediately after the audit period, in May, 1992, taxpayer's accountant suddenly died of an aneurysm. (Taxpayer Ex. No. 2)

CONCLUSIONS OF LAW: The Illinois Income Tax Act imposes penalties for failure to timely file tax returns and for failure to timely pay tax unless it is shown that such failure is due to reasonable cause. 35 ILCS 5/1001; 5/1005.

The existence of reasonable cause justifying abatement of a penalty is a factual determination that can be decided only on a case by case basis (Rorabaugh v. United States, 611 F. 2d 211 (7th Cir., 1979)) and has generally been interpreted to mean the exercise of ordinary business care and prudence (Dumont Ventilation Company v. Department of Revenue, 99 Ill.App.3d 263 (3rd Dist. 1981)). The burden of proof is upon the taxpayer to show by a preponderance of the evidence that it acted in good faith and that it exercised ordinary business care and prudence in providing for the timely payment of its tax liability.

Here, taxpayer has established the existence of reasonable cause by showing that its owners acted in good faith and exercised ordinary business care and prudence. Recognizing their own lack of knowledge of tax related matters, the owners prudently retained the outside services of an experienced accountant whom they had every reason to believe was competent. They reasonably relied upon this accountant and referred all items relating to accounting, payroll, and taxes to her for her attention. The owners had no independent knowledge that the taxpayer was required to file a return and pay income taxes to the state, and in fact were advised by the accountant that no such returns were required. From the time that the accountant was retained until the end of the audit period, all federal returns were filed and there were no audits or notices of tax due to indicate that there were any problems.

Accordingly, I find that reasonable cause existed to abate the penalties proposed pursuant to 35 ILCS 5/1001 and 5/1005. It is my recommendation that the tax liability proposed in the Notice of Deficiency be affirmed and that the penalties proposed be abated.

Wendy S. Paul
Administrative Law Judge